OHT Guide

Finance Act 2011

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Following some turbulent weeks in Dail Eireann the Finance Act implementing Budget 2011 has been passed. The main provisions of the Finance Act (including the post Budget amendments) are set out below.

Bands & Credits

The income tax bands and income tax credits have been reduced by 10% as announced in the December Budget (Click here to view the 2011 tax bands and credits).

This brings the standard rate band and tax credits back to 2006 levels as proposed in The National Recovery Plan.

The effect of these changes is to broaden the tax base. In 2010 only 13% of taxpayers paid tax at the marginal rate but in 2011 at least 18% of taxpayers should be taxed at the marginal rate.

In addition the level of income earners paying no income tax has been reduced from 44.3% in 2010 to 37.9% in 2011.

Age Exemption

From 1 January 2011 the income tax age exemption has been reduced from €40,000 to €36,000 (married couple) and from €20,000 to €18,000 (single person).

Private Health Insurance

The Finance Act abolished health insurance relief for individuals under 60, but relief for individuals 60 years or over has been increased from 1 January 2011:

60-69	relief of €625	(increase of €100)
70-79	relief of €1,275	(increase of €300)
80+	relief of €1,725	(increase of €475)

This provision reflects the rising cost of health insurance for older individuals, due to recent premium increases.

The cost of this relief is to be met by a new Health Insurance Levy (€66 for under 18s and €205 for those aged 18 and over).

Universal Social Contribution

Health Levy and Income Levy have been replaced by a new Universal Social charge (USC) for 2011. The USC is based on the income levy rules, with some adjustments. The USC applies at the following progressive rates:

Under 70

2% €0 to €10,036
4% €10,037 to €16,016
7% €16,017 to €100,000
10% > €100,000*

Under 70 with Medical Cards

2% €0 to €10,036
4% > €10,037

70 or over:

2% €0 to €10,036
4% €10,037 to €100,000
7% > €100,000*

**The increased rates of 7% and 10% only apply to relevant income (essentially self employed income) in excess of €100,000.*

There is an exemption threshold of €4,004 (which applies across the board). However once this threshold has been exceeded the USC applies to all income.

The USC is charged before taking deductions such as pension contributions, S.23 type relief or donations to approved bodies, but it will not apply to income such as bank or credit union interest.

The exemption threshold has decreased significantly. Taxpayers are exempt from USC where the relevant income is €4,004 or under. However taxpayers with income under €15,028 were previously exempt from both income levy and health levy.

A individual who earns €10,000 is now paying an additional 2% as a result of replacing the income levy and health levy with the USC.

PRSI

The PRSI changes are as follows:

- The employees' PRSI ceiling of €75,036 has been abolished
- The Class S (Self-Employed) PRSI rate increased from 3% to 4%
- Modified PRSI rates (for certain public servants) have increased to 4% on incomes in excess of €75,036
- A 4% PRSI charge has been introduced for certain Office Holders

With the introduction of the USC and the abolition of the PRSI ceiling, employees remain at the same top rate of tax of 52% (41% income tax, 7% USC & 4% PRSI) and self-employed taxpayers have also remained at the same top rate of tax of 55% (41% income tax, 10% USC & 4% PRSI).

Although the top rates have not changed they are applying much earlier with the top rate for employees (52%) starting at €75,036 and the top rate for self-employed (55%) starting at €100,001.

Previously the top rate started at €174,980 for both self-employed taxpayers and employees.

Abolition of Income Tax Reliefs

The following income tax reliefs have been abolished or are phased out:

- Tax relief for rent paid on a primary residence (phased out between 2011 & 2017)
- Patent royalty and dividend exemptions (abolished from 24 November 2010)
- The BIK exemption for employer provided childcare has been abolished
- Tax relief for trade union subscriptions has been abolished
- Tax relief for subscriptions to professional bodies has been abolished, bringing them within the charge to income tax, USC and PRSI
- The Act implements the Budget restriction of artists' exemption to €40,000
- Tax relief for shares in approved share option schemes for employees, and for new shares purchased by employees in an employing company, have been abolished

"Section 23 Type" Relief

The Minister announced the removal of S. 23-type relief in Budget 2011. Up to 2010 the capital cost of buying or building a S. 23 property could be deducted as if it were a rental expense, giving rise to a loss which could be deducted from other rents and carried forward indefinitely, provided the property was retained for a 10-year holding period. The Finance Act changes are:

- The relief can only be set against rental income from the relevant property (it is ring-fenced to the S. 23 property)
- If a S. 23 property is sold the relief claimed will be clawed back, but S.23 relief cannot be claimed by the new owner
- Unused relief which is carried forward beyond the normal 10 year holding period will be lost

If the 10 year holding period has already ended when the new provisions take effect any unused relief will be lost. If the 10 year period ends after the new rules come into effect then any relief that is not used by the end of the period will be lost.

If a S.23 property is not let on a qualifying lease within 6 months of the date when the new provisions come into effect, the 10 year holding period will start, effectively shortening the period over which the relief can be claimed.

Accelerated Capital Allowances

The Act provides for the proposed restriction of accelerated capital allowances available under tax incentive schemes. The Act limits the range of income which can be sheltered by the capital allowances (ring-fencing them to income from the relevant property, and preventing a claim for sideways offset against other income).

It also provides that unused allowances can not be carried forward beyond certain deadlines. If a scheme has a 7-year or 10-year tax life,

allowances which are not used at the end of the tax life will be lost.

If the capital allowances were originally allowed over a period in excess of 10 years they will now be restricted to a 7 year period, starting on the date when the allowances were first available.

If the 7-year period has not yet expired the allowances will be reduced by 20%, and the reduced allowances will be spread over the remaining years in the shortened 7-year tax life. If they are not used within this time they will be lost. If this 7-year period (from the original investment) has already elapsed any unused allowances will be lost with immediate effect.

Standard capital allowances (at 4% over 25 years) will not be affected by these new rules, and they only apply to passive investors.

There was an adverse reaction to the Budget 2011 announcement which envisaged that these changes would come in with effect from 7 December 2010.

The Finance Act 2011 pushes back the commencement date for the changes to accelerated capital allowances and S.23 relief until after the impact assessments are published and the Commencement Orders are signed for each.

Third Level Education

In 2010 relief was available at 20% for qualifying third level fees (to a maximum of €5,000). The Act provides that the first €2,000 must be disregarded for full time students, and €1,000 is to be disregarded for part time students. The Student Services Charge (currently €1,500 per annum) was renamed Student Contribution Charge and increased to €2,000. Student Contribution Charge is eligible for tax relief.

Energy Efficiency

A new relief is being introduced to encourage increased energy efficiency for residences. The relief is not available for landlords but other individuals who carry out works to improve the energy efficiency of an Irish residential premises can claim 20% income tax relief on expenditure up to €10,000 (single person) or €15,000 (married couple).

Property-related Tax Provisions

"The Government has decided that they will now be subject to a commencement provision which may only take effect in the next tax year following the preparation and publication of an economic impact assessment on the proposed changes."

"In light of the wide range of concerns that has been expressed regarding the potential effects of the changes on the real economy, and on employment in particular, the Government decided that such an assessment should be undertaken in advance of the commencement of the provisions."

Minister for Finance

The relief will be allowed in the year following the expenditure as a repayment. The scheme will come in by Ministerial Order and will be operated jointly by the Sustainable Energy Authority of Ireland, and Revenue.

There is a cap of €150m on the amount of relieved expenditure in any year. Relief is restricted to a maximum of €15,000 per qualifying residence in the year of assessment.

Grants are still available from the Sustainable Energy Authority of Ireland for home improvements under the Home Energy, Greener Home, and Warmer Homes Schemes. However, the amount of any grant assistance received will be deducted from any claim for income tax relief under this provision.

***Ex Gratia* Payments**

The tax-free element of *ex gratia* termination payments is to be restricted to €200,000 from 01 January 2011. Payments above this amount will be taxed at the marginal rate.

Pensions

Budget 2011 altered the tax treatment of pensions with effect from 1 January 2011 and the Revenue issued a Guidance Note to the new rules (click here). The Act confirmed the Budget provisions and extended the flexible options on retirement (such as access to an Approved Retirement Fund "ARF") to all Defined Contribution (DC) pension arrangements, subject to some transition provisions and adjustments.

The annual earnings limit for tax relief on pension contributions has been reduced from €150,000 to €115,000 for all pension contributions made in 2011 (even if payments are being set back against 2010 income).

The National Recovery Plan proposed reducing tax relief on pensions to 20% by 2014 but the current relief (41%) remains in place for 2011. Employee contributions to occupational pension schemes and other pension arrangements will be subject to employee PRSI and USC, and the current employers' PRSI exemption for employee contributions to occupational pension schemes will be reduced by 50% from 1 January 2011.

The top limit for a tax-relieved pension fund (the Standard Fund Threshold "SFT") has been reduced from €5.4 million to €2.3 million, effective immediately. If the value of a pension fund is higher than the SFT when it is drawn down the excess is subject to income tax at the marginal rate.

A person with a pension fund of over €2.3 million (and under the old €5.4 million threshold) can claim a Personal Fund Threshold (PFT) by 7 June 2011 to avoid this income.

Before Budget 2011 a tax free lump sum of 25% could be claimed on retirement. From 1 January 2011 the tax free sum is capped at €200,000. Payments above €200,000 will be taxed at 20% up to €575,000 (25% of the new SFT), and at the marginal rate above that level. The new €200,000 limit for tax-free lump sums taken from pensions is a lifetime limit so if lump sums are received from more than one pension, each lump sum taken on or after 7 December 2005 will use up part of the €200,000 limit.

The annual imputed distribution for Approved Retirement Funds has been increased from 3% to 5% for asset values at 31 December 2010.

The National Pension Framework recommended that tax relief on pension contributions be reduced to tax relief of 33%, however this recommendation has not been implemented for the tax year 2011. This may be revisited for 2012 and subsequent tax years.

Deposit Interest Retention Tax & Exit Taxes

The rate of DIRT has been increased from 25% to 27% for 2011. The exit tax on life assurance policies and investment funds increased from 25% to 27% for payments made annually, and to 30% for longer term payments, in 2011. The punitive rate of 48% for incorrectly returned Personal Portfolio Investment Undertakings and similar products goes to 50%.

Film Relief

It was announced at the Committee Stage of the Finance Bill that Film relief is to be extended to 31 December 2015.

Employment & Investment Incentive Scheme

The Business Expansion Scheme is to be replaced by a new "Employment & Investment Incentive Scheme" (EIIS) under which a company can raise up to €10 million (the BES cap is €2m); raising up to €2.5m in a 12 month period (currently the limit is €1.5m). This is subject to EU approval and Ministerial Order so the current BES scheme will apply in the interim. The Revenue Guidance Note on EIIS is available here.

The revised scheme provides that a greater range of trades can benefit from capital investment. The revised scheme has simplified certification procedures. The holding period for qualifying shares has also been reduced thereby reducing the risk element of the investment.

However relief has been restricted to 30% of the capital invested (relief is at marginal rates under the BES scheme). Relief of 11% may be claimed at the end of the EIIS holding period if the company manages to increase employment levels or R & D expenditure (giving 41% in total relief).

Start-up Companies: 3 Year Tax Holiday

The 3 year tax "holiday" for start up companies has been extended to 2011. The scheme will be adjusted to link the value of the relief to the employers' PRSI paid by the company in the year of assessment, subject to a maximum of €5,000 per employee. If the amount of qualifying employers' PRSI is lower than the reduction in the corporation tax liability, the relief will be restricted to this lower amount.

Interest on Loans to Invest in Companies

Relief (under S. 248 TCA 97) for interest paid on loans to invest in, or make a loan to, a trading company will be withdrawn on a phased basis. Relief

will not be available on new loans from 8 December 2010, and for existing loans the relief will apply on a reducing basis (falling by 25% per annum) until it is abolished in 2014.

Previously individuals could borrow to invest in the trade of a company in which they had a material interest and set the interest payable on those borrowings against their income (S. 248 TCA 97).

The abolition of this relief in most instances runs contrary to the Minister's stated intention to support new businesses.

Settlements from Close Companies

From 21 January 2011 assets settled in trusts by close companies are to be treated as distributions to the trustees. In addition, if an individual who is a member (or relative of a member) of the close company receives a benefit from the settlement, the amount received will be taxed as income.

Interest Relief for Inter-group Borrowings

The Finance Act provides that relief under S. 247 TCA 97 will not be allowed in respect of interest on intra-group borrowings used to finance the purchase of assets from another group company, and a tax deduction will not be allowed in relation to that interest.

An exception will be made where the assets acquired are used to generate an income that was not within the charge to tax prior to their acquisition, in which case interest relief will be granted up to the amount of income generated by those assets.

VAT

The Finance Act introduced VAT penalties which will apply in a number of circumstances, which include:

- The failure to provide a recapitulative statement for services (i.e. a statement in relation to making intra-Community supplies)
- The failure to keep a capital goods record, or
- The failure to provide the required documentation on the assignment or surrender of a legacy lease.

The Act also provides that the bets and commissions that are being made subject to excise duty in the Act are to be exempt from VAT.

Revenue Powers

The Finance Act included an unheralded extension to Revenue Powers, including most notably - the extended power of Revenue to issue a Notice of Attachment (NOA) to salary and emoluments.

Provision has been made in the Finance Act for statutory deductions, however, no provisions have been made for living expenses of the taxpayer (such as mortgage payments, and household bills) and it appears that the amount of emoluments intercepted at source by Revenue will be at their discretion.

Capital Taxes

For the changes made in Finance Act 2011, regarding Capital Taxes, please refer to Capital Taxes Guide available here.

Conclusion

The Minister focused on income tax in Budget 2011, and subsequently in the Finance Act, and the changes made should have the effect of widening the tax base and bringing more income earners into the tax net. Due to the accelerated passing of the Act and its enactment provisions in relation to Civil Partnerships and a number of administrative issues were not included. It is anticipated that there will be a second Finance Act later in 2011 to make provision for these issues.

Caveat: *These notes are intended as a general guide to Finance Act 2011. OHT has endeavoured to provide an accurate commentary but the notes cannot cover all circumstances. OHT strongly recommends that formal tax advice be obtained before any steps are taken that may have a tax effect.*

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